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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies.	Rulemaking 06-04-009 (Filed April 13, 2006)

California Energy Commission Docket #07-OIIP-01

SUPPLEMENTAL REPLY COMMENTS OF THE NATURAL RESOURCES DEFENSE COUNCIL (NRDC) AND UNION OF CONCERNED SCIENTISTS (UCS) ON ALLOWANCE ALLOCATION ISSUES

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THE NATURAL RESOURCES DEFENSE COUNCIL (NRDC) AND UNION OF CONCERNED SCIENTISTS (UCS) ON ALLOWANCE ALLOCATION ISSUES

I. Introduction and Summary

The Natural Resources Defense Council (NRDC) and Union of Concerned Scientists (UCS) respectfully submit these supplemental reply comments on allowance allocation issues in accordance with the "Administrative Law Judge's Ruling Extending Comment Deadlines and Addressing Procedural Matters" (ALJ Ruling), dated November 30, 2007, and in accordance with Rules 1.9 and 1.10 of the California Public Utilities Commission's (CPUC) Rules of Practice and Procedure. NRDC/UCS also concurrently submit these comments to the California Energy Commission (CEC) in Docket #07-OIIP-01, the CEC's sister proceeding to this CPUC proceeding.

NRDC is a non-profit membership organization with a long-standing interest in minimizing the societal costs of the reliable energy services that a healthy California economy needs. In this proceeding, NRDC represents its more than 124,000 California members' interest in receiving affordable energy services and reducing the environmental impact of California's energy consumption. UCS is a leading science-based non-profit working for a healthy environment and a safer world. Its Clean Energy Program examines the benefits and costs of the country's energy use and promotes energy solutions that are sustainable both environmentally and economically.

The ALJ Ruling permits supplemental reply comments that address the supplemental comments filed by Pacific Gas and Electric Company (PG&E) and Southern California Public Power Authority (SCPPA); Western Resource Advocate's (WRA) alternative allocation proposal; and SCAQMD's late filed comments.[1] NRDC/UCS submit these supplemental reply comments to PG&E and SCPPA's supplemental comments, in addition to our opening and reply comments submitted earlier on allowance allocation and distribution issues in a greenhouse gas (GHG) regulatory system for the electricity and natural gas sectors.[2] In summary, our reply comments elaborate on the following key points:

- SCPPA greatly exaggerates the cost of auctioning allowances in a load-based approach, as auction revenues should be used to benefit the load-serving entities' customers, reduce emissions and to lower costs.
- SCPPA's concerns regarding wealth transfer from more GHG-intensive retail providers to less GHG-intensive retail providers under an output-based allowance allocation system overlooks the ability for retail providers to reduce their own emissions, and the fact that wealth transfer would also occur in the opposite direction under grandfathering of allowances.
- As PG&E illustrates, the Commissions should carefully consider the harm to California under a national GHG cap-and-trade program if California were to establish the regrettable precedent of grandfathering allowances.

II. SCPPA greatly exaggerates the cost of auctioning allowances in a load-based approach, as auction revenues should be used to benefit the load-serving entities' customers, reduce emissions and to lower costs.

[1] ALJ Ruling, p. 4.

[2] NRDC/UCS, "Opening Comments of the Natural Resources Defense Council (NRDC) and Union of Concerned Scientists (UCS) on Allowance Allocation Issues," October 13, 2007; and NRDC/UCS/GPI, "Reply Comments of the Natural Resources Defense Council (NRDC), Union of Concerned Scientists (UCS), and Green Power Institute (GPI) on Allowance Allocation Issues," November 14, 2007.

SCPPA claims that auctioning allowances under a load-based system "would have a potentially massive impact on the retail price of electricity that is charged to consumers," arguing that auctioning allowances would require retail providers to acquire those allowances at a cost of $2-4 billion in 2008, depending on the cost of allowances that range from $25-50 per ton (p. 2), *in addition* to the costs of lowering their GHG emissions (p. 3). However, SCPPA's claim is incorrectly based on the blanket assumption that the auction revenues would simply disappear and *none* of the auction revenues would return to benefit the retail consumers' customers. By citing Health and Safety (H & S) Code Section 38597, SCPPA claims "it is highly unlikely that 100 percent of the revenues or even some lesser but nevertheless substantial percentage of the revenues that are derived from retail providers...would actually be returned to those utilities for GHG reduction efforts." (p. 21)

However, as explained in NRDC/UCS/GPI's November 14, 2007 reply comments, CARB can derive the authority to create an auction from multiple sections of AB 32 independently of H & S Code Section 38597, the provision upon which SCPPA solely relies for their argument against auctions.[3] Therefore, it is far from certain that auction revenues would be required to be deposited in the Air Pollution Control Fund, pursuant to Section 38597. Given that CARB has not decided whether to implement a cap-and-trade system, or whether to use an auction to distribute allocations under such a system, it is of course reasonable that no guarantees have yet been made about the eventual destination of any potential auction revenues. When the time comes to make those specific policy decisions, auction revenues must be used for purposes related to AB 32, and returning revenues to utilities to be used in achieving AB 32 objectives would be an appropriate and legitimate use of the revenues. NRDC/UCS urge the Commissions to *first* decide if an auction is the best allowance distribution mechanism; if the Commissions so decide, they should strongly recommend that the auction be designed to avoid diversion of revenues, rather than completely ruling out auctions from the start as SCPPA recommends.

By incorrectly assuming that auction revenues will not be dedicated to furthering the goals of AB 32, SCPPA greatly exaggerates the costs to customers of auctioning

[3] NRDC/UCS/GPI Reply Comments, November 14, 2007, p. 9-10.

allowances. Using auction revenues to further the goals of AB 32 would help to reduce the overall costs to customers. In particular, a substantial portion of auction revenues should be used to support (but not replace existing funding for) energy efficiency, which produces significant net *savings*, not costs as SCPPA claims (p. 3), to customers. NRDC/UCS have previously suggested other mechanisms to mitigate the cost to consumers of an auction, including the recommendation that utilities could also be allowed to keep a portion of the amount they spend in the auction to invest in specified GHG emissions reductions, subject to oversight and verification that the investments meet appropriate criteria.[4]

III. SCPPA's concerns regarding wealth transfer from more GHG-intensive retail providers to less GHG-intensive retail providers under an output-based allowance allocation system overlooks the ability for retail providers to reduce their own emissions, and the fact that wealth transfer would also occur in the opposite direction under grandfathering of allowances.

SCPPA asserts that "allocating allowances among retail providers on the basis of each retail provider's retail sales…would result in a wealth transfer from the retail providers that currently have a more carbon intensive resource mix to those that do not" (p. 4-5). In its analysis supporting this argument, SCPPA claims that an output-based allocation for 2008 would result in a wealth transfer of over \$250 million to over \$500 million, assuming allowance values of \$25 to \$50 per ton, from southern California publicly owned utilities (POUs) to other California utilities (p. 7). However, SCPPA appears to assume that load-serving entities, if they are the point of regulation for GHG emissions, *only* have the option of purchasing allowances from other entities holding allowances in order to meet their compliance responsibility. In its attempt to "prove" that a wealth transfer would occur, SCPPA conveniently overlooks the most important option available to retail providers to meet their compliance responsibility: lowering their own GHG emissions through various strategies, including cost-effective energy efficiency, which produces net savings and reduces the amount of allowances that a retail provider must acquire.

[4] See NRDC/UCS Opening Comments, October 31, 2007, p. 10.

It is important to note that, if allowances were to be grandfathered per SCPPA's recommendation, "wealth transfer" would occur in the opposite direction, from cleaner to dirtier utilities. NRDC, UCS and GPI previously raised this possibility in our November 14, 2007 reply comments.[5] Since higher-emitting utilities typically have more low-cost opportunities to reduce their emissions, grandfathering allowances would effectively create a "wealth transfer" from lower-emitting utilities to higher-emitting utilities. This could even require the customers of those cleaner utilities to "pay twice" for AB 32 compliance since they have already paid once for energy efficiency, renewable energy, and other clean energy resources. Of course, the actual outcome would depend on the particular circumstances of any given utility. Again, we urge the Commissions to focus on the core equity impacts for all entities involved, since these "wealth transfer" arguments can be made about any allowance distribution system.

IV. As PG&E illustrates, the Commissions should carefully consider the harm to California under a national GHG cap-and-trade program if California were to establish the regrettable precedent of grandfathering allowances.

PG&E's analysis shows that "Using 2006 recorded sales and GHG emissions, and assuming an allowance price of $20/metric ton of CO2, the cost of allowances to California would be $2.1 *billion* per year higher [than an output or sales based allocation method] under a 'grandfathered' or historical emissions based allocation method" (p. 23, emphasis added). This underscores the importance of the precedent for a national system that California establishes through the design of its own cap-and-trade system. NRDC/UCS urge the Commissions and CARB to set a good example for allowance allocation that would not harm California consumers if it is translated to a federal system.

In arguing against an output based allocation, SCPPA claims that the southern California POUs will have to "wean themselves from the carboniferous resources that were added decades ago in compliance with state and national policies that existed at the time" (p. 7) However, as PG&E convincingly demonstrates, "the risk of greenhouse gas emissions and potential action to constrain those emissions were identified and acknowledged by public policymakers and other decision-makers in California and

[5] NRDC/UCS/GPI Reply Comments, November 14, 2007, p. 7-8.

elsewhere" since at least 1990 (p. 21). California should not adopt a grandfathering allowance allocation system that would shield those entities that took on the risk of investing in high GHG-emitting resources in the face of this mounting knowledge of the risks of emitting GHGs. NRDC/UCS urge the Commissions to reject grandfathering of allowances.

V. Conclusion

NRDC and UCS commend the Commissions for carefully examining the issues surrounding the appropriate allowance distribution method. We urge the Commissions to recommend a mechanism that is in the public interest, and that distributes the allowance value to benefit consumers and to invest in emission reductions.

Dated: December 7, 2007

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **"Supplemental Reply Comments of the Natural Resources Defense Council (NRDC) and Union of Concerned Scientists (UCS) on Allowance Allocation Issues" in the matter of R.06-04-009** to all known parties of record in this proceeding by delivering a copy via email or by mailing a copy properly addressed with first class postage prepaid.

Executed on December 7, 2007 at San Francisco, California.

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